

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
OGGI RESTAURANT, INC.	:	DETERMINATION
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1984	:	
through May 31, 1987.	:	

Petitioner, Oggi Restaurant, Inc., 1606 First Avenue, New York, New York 10028, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1984 through May 31, 1987 (File No. 805142).

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on September 19, 1989 at 9:15 A.M. Petitioner appeared by Squadron, Ellenoff, Plesent & Lehrer (James Stevralia, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Lawrence A. Newman, Esq., of counsel).

ISSUES

I. Whether, based upon books and records made available, the Division of Taxation properly determined additional sales tax due from Oggi Restaurant, Inc. for the audit period.

II. Whether penalties and interest in excess of the minimum assessed herein should be remitted to petitioner.

FINDINGS OF FACT

Pursuant to a field audit which commenced in December 1986, the Division of Taxation, on January 20, 1988, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to Oggi Restaurant, Inc. ("petitioner") in the amount of \$60,811.82, plus penalty and interest, for a total amount due of \$92,936.88 for the period March 1, 1984 through May 31, 1987.

Previously, petitioner had executed consents extending the period of limitation for assessment of sales and use taxes as follows:

<u>Executed</u>	<u>Period</u>	<u>Date to Assess Tax</u>	<u>By</u>
12-29-86	12-1-83 through 2-28-84	6-20-87	Attorney
4-16-87	3-1-84 through 5-31-84	9-20-87	Attorney
7-21-87	3-1-84 through 8-31-84	12-20-87	Attorney

11-13-87

3-1-84 through 11-30-84

3-20-88

Vice-president

For the period at issue, petitioner operated a restaurant (primarily Italian cuisine) and bar located at 1606 1st Avenue (at 83rd Street) in New York City.

On December 12, 1986, the auditor sent an appointment letter to petitioner which requested all books and records pertaining to its sales tax liability for the period December 1, 1983 through November 30, 1986. The first quarter (December 1, 1983 through February 28, 1984) was subsequently withdrawn from this audit period since it had been included in a prior audit. The auditor met with petitioner's attorney and its accountant on a few occasions to review available records and to prepare markup schedules. On April 16, 1987, the auditor left with petitioner's attorney a revised list of items needed for future meetings (this list requested records through February 28, 1987). For the last quarter at issue herein (March 1, 1987 through May 31, 1987), a request for books and records was made orally to petitioner's attorney by the auditor.

The only records made available to the auditor were a general sales ledger, a cash disbursements journal and Federal income tax returns for 1984 through 1986. No cash register tapes or guest checks were presented to the auditor. Petitioner's general sales ledger consisted of cash receipts and charge sales totals. Without the source documents, i.e., guest checks and cash register tapes, the auditor deemed petitioner's books and records to be inadequate. As a result thereof, the auditor chose to utilize petitioner's purchases per its records and to apply the food, beer and liquor markup percentages which had been calculated during a prior audit (March 1, 1981 through February 29, 1984). These markup percentages were 149 percent for food, 297.18 percent for beer and 382.17 percent for liquor. Applying these markup percentages to petitioner's purchases during the audit period resulted in adjusted sales of \$2,422,089.88 of food, \$174,635.56 of beer and \$1,161,666.72 of liquor (\$3,758,392.16 total adjusted sales). On its sales tax returns for the period, petitioner had reported taxable sales of \$3,021,277.00. The difference between adjusted and reported sales for the period was, therefore, determined to be \$737,115.16. The auditor then calculated a margin of error (\$737,115.16 divided by \$3,021,277.00) of 24.3974 percent which he used to determine additional taxable sales for each of the sales tax quarters at issue. By applying the appropriate sales tax rate (8¼ percent), additional tax due was determined to be \$60,811.82 for the audit period.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner's position may be summarized as follows:

(a) The primary contention of petitioner is that allowances for employee consumption of both food and liquor should have been made by the auditor. Petitioner's accountant, Ernest T. Pettinato, testified that, for most of the audit period, the owners were not on the premises and that, as a result thereof, the business was mismanaged.¹ Mr. Pettinato alleges that there were approximately 30 to 32 employees at the restaurant (approximately 22-25 per day) and that these employees ate two meals per day at the restaurant (these employees could eat anything on the menu except steak, which an employee could order only once per week). The accountant estimated the cost per meal at \$7.00 to \$8.00. In addition, he alleges that alcohol consumption was unusually high as a result of the employees being permitted (due to poor

¹It must be noted that Mr. Pettinato admitted that he had not been to the restaurant since the beginning of the audit period (1984).

management and absentee ownership) to consume liquor whenever they desired. In furtherance of the contention of mismanagement, petitioner produced documents entitled Service and System Reports. The name Better Service Bureau appeared at the bottom of each report. Reports were produced which indicated that visits (approximately 8 or 9) had been made to the bar and to the restaurant at various times from June 1984 through April 1986. The reports stated that, during some of the visits, the bartender gave drinks to certain customers and did not ring up correct amounts. The report also indicated that the bartender, the manager and certain other employees consumed alcohol while working.

(b) Petitioner's accountant does not recall agreeing to the use of the markup percentages from the prior audit. He stated that guest checks were available and were shown to an auditor (he cannot recall whether they were shown during this audit). Mr. Pettinato stated, however, that the guest checks were in boxes in the basement but, because the basement was flooded, he did not feel that the auditor would want to examine them. The accountant stated that he prepared petitioner's sales tax returns during the early part of the audit period, but that the bookkeeper prepared the returns thereafter. Even when he prepared the returns, Mr. Pettinato admitted that the returns were prepared from the bookkeeper's ledgers rather than from source documents (register tapes and guest checks).

(a) The Division of Taxation contends that petitioner's attorney (Mr. Stevralia) and its accountant (Mr. Pettinato) agreed to the use of the markup percentages from the prior audit at a meeting held at the attorney's office on May 26, 1987. Form DO-220.5 (Tax Field Audit Record) contained within the Field Audit Report sets forth the auditor's contacts and comments concerning this meeting.

(b) The Division's position is that despite proper requests therefor, petitioner failed to make available source documents (cash register tapes and guest checks) which were necessary to verify the accuracy of petitioner's sales ledgers and that, without such documents, resort to the use of markup percentages calculated for an audit period immediately

prior to the period at issue was a reasonable audit method to determine petitioner's taxable sales.

(c) The Division argues that, without testimony and credible documentation in support thereof, petitioner is not entitled to allowances for food and/or liquor given away to customers and employees.

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices. The resort to external indices is predicated upon a finding of insufficiency in the taxpayer's record keeping such that verification of sales is a virtual impossibility (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44). In such circumstances, the Division of Taxation must select a method of audit reasonably calculated to reflect tax due (Matter of Grecian Square v. State Tax Commn., 119 AD2d 948), and the burden is on petitioner to establish by clear and convincing evidence that both the method used to arrive at the tax assessment and the assessment itself are erroneous (Matter of Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943).

To determine the adequacy of a taxpayer's records, the Division of Taxation must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, lv denied 71 NY2d 806;

Matter of King Crab v. State Tax Commn., 134 AD2d 51). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn., *supra*; Matter of Ronnie's Suburban Inn, Inc., Tax Appeals Tribunal, May 11, 1989).

In the present matter, petitioner failed to make available guest checks or cash receipts from which the auditor could verify the accuracy of its sales ledgers.

In Matter of Ronnie's Suburban Inn, Inc. (*supra*), the Tax Appeals Tribunal, citing Matter of Licata v. Chu (64 NY2d 873), stated that:

"[p]etitioner's lack of guest checks or cash register tapes separately stating the tax due on each sale precludes it from claiming that the auditor was supplied with sufficient books and records".

The Tribunal further stated that it is not reasonable to expect that the Division of Taxation will exclusively rely upon a taxpayer's non-source documentation and, in effect, to determine the correct amount of tax due based upon a taxpayer's general ledgers (Matter of Meyer v. State Tax Commn., 61 AD2d 223, *lv denied* 44 NY2d 645). In the present matter, it is clear that the failure of petitioner to make available guest checks or cash register tapes for the audit period made it impossible for the auditor to verify its sales ledgers. It was, therefore, permissible for the auditor to resort to external indices to determine the correct amount of tax due. It must then be determined whether or not the method selected (application of markup percentages from a prior audit to petitioner's purchases during the audit period) was a method reasonably calculated to reflect tax due.

While there is some question as to whether petitioner, by its attorney or accountant, actually agreed to the use of the markup percentages from the prior audit, petitioner does not affirmatively contend that it did not agree, i.e., the allegation herein is that its representatives do not recall entering into such agreement. Moreover, agreement to the utilization of a particular audit method is not necessary. It is only necessary that the Division select an audit method reasonably calculated to reflect the tax due and it is then incumbent upon petitioner to establish that the method utilized results in an unreasonably inaccurate assessment or that the resulting assessment is erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813). In the present matter, petitioner has presented no evidence which would indicate that the audit method employed did, in and of itself, result in an erroneous assessment. Petitioner's primary criticism of the audit concerns the auditor's failure to make allowances for beer and liquor which was given or sold at reduced rates to customers and for food, beer and liquor which was consumed by petitioner's employees.

The evidence produced by petitioner to show entitlement to the aforesaid allowances consisted of testimony by petitioner's accountant who admittedly had not visited the premises since the early part of the audit period and certain documents entitled Service and System Reports for which little or no explanation or clarification was offered. Petitioner's accountant, Ernest T. Pettinato, testified as to the amount and frequency of employee consumption of food and alcohol. None of the principals of the corporation or the restaurant's employees appeared at the hearing to offer testimony to substantiate the allegation concerning substantial employee consumption. As for the Service and System Reports (*see*, Paragraph "6"), while such reports do indicate some give-aways by the bartender and some employee consumption of alcohol, no evidence was introduced concerning the preparation of such reports, i.e., who prepared the reports, who ordered the reports, the periods during which visits were made to the premises, etc. While petitioner may well be entitled to some allowances, it is petitioner which bears the burden of proving both such entitlement and the correct amount for such allowances. Petitioner

has failed to prove, by clear and convincing evidence, the proper amounts which should be allowed for give-aways and for employee consumption of food and alcoholic beverages. Accordingly, the Division of Taxation's assessment of additional tax due is hereby determined to be reasonable under the facts and circumstances herein.

B. Petitioner has produced no evidence that its failure to pay over the proper amount of sales tax was due to reasonable cause and not due to willful neglect. Absentee ownership and the resulting mismanagement resulting therefrom does not constitute reasonable cause. If the Service and System Reports referred to above can be found to be even slightly credible, these reports, taken together with the testimony of petitioner's accountant which indicates that the corporate principals were made aware of the ongoing employee abuses, clearly show that little or nothing was done to alleviate these problems. Since petitioner apparently allowed these practices to continue, its reliance on these alleged abuses to constitute reasonable cause for failure to collect and pay over the proper amount of sales taxes is wholly without merit. Accordingly, penalties and interest assessed herein are sustained.

C. The petition of Oggi Restaurant, Inc. is denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued to petitioner on January 20, 1988 is sustained in its entirety.

DATED: Troy, New York
March 8, 1990

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE